

Part III-Preambles Published Under the FAR System

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Preamble A to 30.404, Capitalization of Tangible Assets

This final rule, in Federal *Acquisition* Circular (FAC) 84-38, revises 30.404-40(b)(1), 30.404-60(a)(1), and 30.404-60(a)(1)(i).

Summary

Section 30.404 requires that contractors have written policies for capitalization which *must* include a minimum *acquisition* cost criterion of \$1000. The standard is being amended to raise the threshold to \$1500. The purpose of the change is to permit contractors to adopt practices appropriate in today's economy.

Effective Date: The effective date of this modification is September 19, 1988.

Background

Supplementary Information. The CAS Board established the minimum *acquisition* cost criterion for capitalization at \$500 when it originally promulgated CAS 404 in 1973. The Board's initial \$500 limitation encompassed the practices of 97 percent of the companies whose Disclosure Statements were filed with the Board. In the promulgation comments to the Standard, the Board recommended that the special limits in the standard "...*may* need to be reviewed in the future...(and will be revised) promptly if developments warrant a change."

On March 3, 1980, the Board did revise the limitation upward to \$1000 as it recognized that circumstances had changed significantly since the promulgation of Standard 404. The Board found that the performance of several official indices showed increases from 60 to 80 percent, and a survey of companies not influenced by the limitation of Standard 404 showed a significant number using \$1000 as the minimum criterion for capitalization.

The impact of inflation has continued over the 7 years since 1980, although at a lower level. Indices from the Commerce Department for the implicit price deflators on nonresidential structures and machinery and equipment showed increases from 30 to 35 percent over the period 1979 through 1985. When applied to the current \$1000 criterion, this yields values from \$1300 to \$1350. In addition, economic projections showed inflation levels rising slightly from 1986 through 1989. Consequently, this change increases the minimum *acquisition* cost criterion for capitalization of tangible capital assets to \$1500 to cover both actual and projected price increases.

The amendment which is now being promulgated is derived directly from the proposed rule which was published in the *Federal Register* on July 9, 1986 (51FR24971), with an invitation for interested parties to submit comments.

Four letters of comment were received on the July 9, 1986, proposal. Only one letter directly addressed the appropriateness of the proposed revisions to 30.404. That comment stated that

inflation *should* not be the motivating factor in determining significant costs for capitalization, but rather materiality of the cost *should* be the factor in determining significance.

The CAS Board's comments in the CAS 404 preamble and its action to increase the capitalization threshold based upon inflation, discussed above, indicate that the Board considered the materiality and significance of asset *acquisition* cost to be directly related to the level of prices in the economy. The Defense *Acquisition* Regulations Council and the Civilian Agency *Acquisition* Council agree with the CAS Board's outlook on this matter and expect the increase in capitalization threshold provided in this modification to 30.404 will be beneficial to Government *contract* costing by not requiring capitalization of assets that are of insignificant value.

Preamble A to 30.416, Accounting For *Insurance* Costs

This final rule, in Federal *Acquisition* Circular(FAC) 84-38, revises 30.416-50(a)(3)(ii).

Summary

FAR30.416-50(a)(3)(ii) revisions delete the requirement to use state rates in discounting certain self-insured losses to present value.

Effective Date: The effective date of this modification is September 19,1988.

This modification *shall* be followed by each contractor on or after the start of its next cost accounting period, beginning after receipt of a *contract* to which this modification is applicable.

Background

Supplementary Information. Section 30.416 provides that the amount of *insurance* cost to be assigned to a cost accounting period is the *projected average loss* (PAL) for that period plus *insurance* administration expense in that period. The PAL is either the *insurance* premium, where the risk of loss is covered by the purchase of *insurance* , or a *self-insurance* charge, where the exposure to risk is not covered by the purchase of *insurance* . Where it is probable that the actual amount of losses will not differ significantly from the PAL, the actual amount of losses *may* be considered to represent the PAL for the period as the *self-insurance* charge.

In *self-insurance* , when the actual amount of losses is being used to represent the PAL, contractors are to discount those losses to present value, where payments to the claimant will not take place for over a year after the loss occurs. If a state provides a discount rate for computing lump-sum settlements, 30.416 requires that the state rate be used for computing present value. Otherwise, the Pub.L.92-41 Treasury rate is to be used. The differing rates specified by the states, and the lack of specified rates in some states, result in inconsistent treatment of *self-insurance* charges on defense contracts.

The purpose of requiring a present value computation for *contract* cost accounting purposes is to recognize the time value of money for funds advanced to and used by the contractor for extended periods before being disbursed. The Pub.L.92-41 Treasury rate is generally specified for this purpose. The majority of state laws covering worker's compensation *insurance* specify a rate in the range of 3-6percent. The use of a low rate results in a larger settlement than would use of a current money market rate. The purpose of low state rates is to discourage lump-sum settlements. This purpose is unrelated to that of fair valuation for *contract* cost accounting purposes. The use of state rates *may* produce inaccurate measures of present values and will most certainly create inconsistencies in the *pricing* of contracts due to the lack of consistent determinations of present values. Consequently, the proposed rule, published in the *Federal Register* on July 8,1986

(51FR24788), deleted the reference to state discount rates at 30.416-50(a)(3)(ii) and required use of the Pub.L.92-41 Treasury rate in all cases.

Four comments were received in response to the proposed rule. None of the comments directly challenged the appropriateness of the proposed revision. Therefore, no changes were made to the proposed rule as a result of the public comments.